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## Infusing Business Finance with Ethical Dilemmas

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### Abstract

Wall Street greed and business scandals prompt the criticism that business education lacks a critical ethical component. This paper shares one response to this critique detailing a series of assignments requiring students in a basic business finance class at Regis College to write memos solving ethical dilemmas related to the course content. This paper also reports students' assessments of the series of assignments

### Introduction

Making the right choices in the financial world can be difficult. Bernard Madoff's decisions were blatantly wrong.<sup>1</sup> But what ought a borrower to do when the value of her house falls below the balance on her loan? How should a legislator vote when the issue of usury laws comes up? These ethical dilemmas do not have clear right and wrong answers. They are tough.

Business educators, particularly those who teach finance and accounting, have been criticized for doing too little to train students to make ethical decisions once they leave the classroom.<sup>2</sup> Demanding content often takes higher priority than addressing business ethics.<sup>3</sup> But Joel Podolny's comment in the *Harvard Business Review*, "Fact is, so deep and widespread are the problems afflicting management educations that people have come to believe that business schools are harmful to society, fostering self-interested, unethical and even illegal behavior by their graduates" demands a response.<sup>4</sup>

This paper discusses one response, sharing some ideas to challenge students in a core business finance class to write memos that allow them to practice ethical decision making.

### Literature

The accrediting body for business schools (AACSB) has required ethics education in the business curriculum for a long time. In 2003, AACSB dedicated a special task force to review

ethics content in courses. But in 2009, Nicholson and DeMoss write, "Despite recurring calls for ethical business education and inclusion of socially responsible business practices, the status of these topics in business education has not undergone a significant increase."<sup>5</sup>

Nicholson and DeMoss investigate the perceptions of ethics education in various business disciplines by asking discipline coordinators how much ethics coverage there is in each of their specific disciplines, how much there should be, and how important it is. They report that the ratings for finance, compared to accounting, management and marketing, are the lowest on all three dimensions. This is not too surprising. Cagle, Glasgo, and Holmes and report, "Articles discussing how to teach financial ethics are still uncommon."<sup>6</sup> Cagle, Glasgo, and Holmes add to the literature of teaching financial ethics with a study exploring whether discussion of 12 textbook "ethics vignettes" in classes "would be an effective way to teach ethics."<sup>7</sup> They measure the effectiveness of this experiment using pre- and post-vignette surveys of students' chosen solutions to 10 ethical dilemmas. Though the mean scores for choosing the ethical response rose for nine of the 10 dilemmas, the differences were not statistically significant. Because the literature on the power of classroom experiences to change ethical standards is mixed, this was not unexpected. The authors theorize that discussion, though it involves more active-learning than lecture, is still not sufficiently engaging to change ethical standards.

May, Luth, and Schwoerer (2009) find more encouraging results for students enrolled in a course exclusively dedicated to ethical decision making. Comparing pre- and post-test data for students in the semester-long ethics class versus students in a control group, they document greater increases in ethical decision making skills among the students enrolled in the ethical decision making course. Those in the class reported greater increases in moral efficacy (confidence in dealing with ethical dilemmas in the right way), moral meaningfulness (valuing making the right choices), and moral courage (willingness to act on moral principles).<sup>8</sup>

### This Paper

This paper shares some ideas for incorporating ethics into a finance class that go beyond discussion of textbook vignettes by asking the students to discuss *current* and course-content-related dilemmas *and* to communicate their resolutions to the dilemmas in written memos. But these memos are only one component (20% of the final grade) of a standard, required finance course, not an entire course as in the May, Luth and Schwoerer study.

The students also write a final memo to me assessing the memo-writing experience and advise whether or not the assignments should be continued. The next section summarizes some ideas for memo assignments. The section following that reports students' reflections in their final memos. The final section offers comments.

### Memo Ideas

In most finance classes students do not consider tough ethical questions, but market economies work better when people behave ethically. Without a moral conscience, government regulation alone cannot create a level playing field. Because there is evidence that practice making hard choices makes it easier, the students in Business Finance classes at Regis College write a series of memos that suggest solutions to ethical dilemmas that are related to *current* issues and are connected to the content in the finance core.

For all of the memos, the students use readings posted on Santa Clara University's Markkula

Center for Applied Ethics<sup>9</sup> and the Arizona Character Education Foundation<sup>10</sup> websites to provide a substantive framework to support the advice in their memos. The challenge is to repeatedly apply the principles of ethical decision-making to specific finance problems. Each decision has to be explicitly backed by at least one of the "Five Sources of Ethical Standards" (Utilitarian, Rights, Fairness or Justice, Common Good, and/or Virtue).<sup>11</sup>

The first ethical dilemma the students consider is whether a borrower should default on a mortgage loan with a balance in excess of the house's value. This problem continues to make headlines despite the recovery in the housing market. This dilemma challenges students to think beyond the "numbers" and self interest to consider what is "just," what impact choices have on the "common good," and what actions promote "virtue." It also raises awareness of the impacts of the financial crisis on individuals.

Another assignment asks the students to write a memo to a legislator advising a vote for or against a bill to cap interest rates charged by payday lenders. Payday lenders charge notoriously high interest rates which they justify by saying they are serving a population that no one else will. This assignment provokes heated debate along ideological lines. Conservative students argue for a hands-off approach using a rights approach, while more liberal students emphasize the virtue and fairness approaches.

Students also consider the tension between finance practitioners and academics. Practitioners believe that Wall Street traders can add value – earn higher returns by buying and selling the right investments at the right time compared to just buying a representative sample of securities and holding them. But academic research shows this is an illusion. The data overwhelmingly demonstrate that most professional investors do not add value. And there is a large literature in behavioral finance documenting that investors routinely make mistakes, even highly paid professionals. After reading the literature, the students write memos to friends who had been offered jobs at hedge funds – where professional investors are expected to add value – advising the person to either take or refuse the job. Essentially

the dilemma is whether taking a job paying a lot of money, but doing something that data show will most probably not add value to society, is an ethical choice.

Another assignment deals with insider trading. Insider trading is illegal, so for this memo there is a clear answer. But the students find the assignment challenging because the first impulse is to use the information for personal gain. "I saw a big difference between what was the easiest decision to make and what was the right decision to make ... it is really easy to be tempted to use insider information," wrote one student. Insider trading makes headlines every semester. Recently the whole hedge fund industry has been under fire for using insider information to gain an advantage over ordinary investors. This opens the opportunity for students to consider whether their friends should take jobs at hedge funds after they learn that the funds tell investors that it is their business *connections* that produce attractive returns.

Another memo asks students to consider the ethics of leverage. When companies choose a capital structure which involves large amounts of debt it increases the risk of bankruptcy but heightens rewards for equity investors if things go well. Students consider whether this implies anything about the ethics of the company and hence about the attractiveness of investing in such a company. This is a complicated challenge from a financial perspective; however, I ask the students to abstract away from the financial complexity of capital structure policy per se and focus on the ethical dimension of the company's decisions to take on large amounts of debt.

Every semester events in the financial world create opportunities for similar assignments, so the topics and challenges change to reflect what's going on in the world outside the classroom. But they all require the students to think about issues from an ethical perspective that demands they consider their responsibilities to community.

### Students' Evaluations

In the final anonymous memo, addressed to me, the students evaluate their experiences and discuss the pros and cons. They also make recommendations to either continue this exercise for future business finance classes or to eliminate

it. The overwhelming majority of the students advise me to continue to assign ethics memos.

One honest student wrote:

"This is hard for me to tell you to continue since I despise writing papers. However these memos were a big help in a few of my classes. ... All in all I hated the memos as I was writing them, but I did realize they were very beneficial to me."

Another student quoted a Chinese proverb:

"Tell me and I'll forget; show me and I may remember; involve me and I'll understand."

Students back their strong recommendations to continue the exercises with substantive comments about what they learn. Requiring them to use the readings on ethical decision making to justify their solutions to the dilemmas make them think about *why* a decision is a good one or a bad one.

"I learned how to think critically about ethics, to really think about different reasons why something may be ethical or unethical."

"I saw a big difference between what was the easiest decision to make and what was the right decision to make."

"The memos made me think about my community, my friends, affects of others' actions and what is expected of me as a human being."

Focusing on current, relevant issues and role playing also helps.

"The ethical issues were on point with what was happening in the financial world around us. Putting yourself in a place that allowed evaluation and consideration of decisions was a good exercise that I have not encountered in any of my business classes this semester at Regis."

Other students echo this sentiment:

"They offered me the opportunity to think about the subject matter of the class in real world situations. Through that exercise I was able to more deeply understand what I was

learning and the direct application of that knowledge...”

“I did enjoy learning about the current events in the financial world. ... no matter how many textbooks you read that give generic information, there is no point in learning if you cannot apply it to our surrounding world.”

“It helped us illustrate the concepts of the class with real world examples.”

Students also write that the memos expand the things they think about and their discussions outside of the classroom.

“... all the memos really helped us think about issues we wouldn’t have otherwise.”

“Interestingly, these memos stirred something inside of me to discuss these issues with others. I was interested in the dilemmas and they were great ways to start up conversations with colleagues, friends and family.”

Students also emphasize that these exercises heighten awareness because they illustrate how tough decisions in the business world can be and how easy it is to make bad decisions.

“I think these kinds of assignments go a long ways. It is really easy to go with the flow around you in the real world. There are many people to impress and money to be made. Without a moral ethical conscience or compass, it is easy to see how so many people are lead [sic] astray.”

This heightened awareness translates into interaction and curiosity.

“I also would talk to a lot of people about these memos and the articles and [they] expanded their minds on the situation.”

“Reading about the current issues helped me to become more interested in finance and even to research some of the topics discussed.”

These exercises also help students more completely understand financial issues and to take a break from lecture, theory, and calculations.

“I think they added diversity to the class and it was an alternative form of learning not only about ethical decision making but they served as insight into other financial issues. ... Otherwise I do not think I would have fully understood the issue with people purposely defaulting on a mortgage or how insider trading really works.”

At a skills level, students appreciate practicing writing memos – something many of them had never done despite being juniors and seniors majoring in business.

“It was also very helpful to learn the proper format for a memo. In almost every job people use memos to communicate with each other. I learned that memos are supposed to be very concise and to the point.”

“I learned how to write a memo and summarize my thoughts into a professional and well written response.”

“They were of great help learning ... I, personally, have never written a memo until now.”

Overall, many of the students’ final memos are eloquent justifications of the time and effort we all spend in the endeavor. Nevertheless, a small majority of students argue that these memos are not a good use of time primarily because ethics is covered in other courses and finance content is more important.

“As business majors we have to take ethics anyway, also we have to do ethics projects in the Management class as well. I feel like it might be overdone and unnecessary in this class. Of course it is good information to know but I feel like it does not fit the objectives of this course.”

“... my time could have been used more wisely in the understanding of finance.”


### Comments and Reflections

In a complex world, it’s important to give students the opportunity to think about questions that don’t have obvious answers and let them practice

making difficult decisions using a rigorous framework. Too often we act in haste without considering the consequences. The objective of these exercises was to help students slow down and consider higher values and consequences.

Reflections on these assignments are encouraging. Repeated practice using a rigorous framework to justify decisions helps students gain confidence in finding ethical solutions, and they overwhelmingly recommend that other students coming after them have these same opportunities.

Nevertheless, there are some important considerations for making these exercises work. The memo assignments must be related to issues that are current and relevant to the finance content of the class. This is not always easy. It takes significant time and reflection to construct the assignments. It's also necessary to devote class time to instruction on and discussion of the issues. The students need briefing on what the issue is and why it is important. They also need time for class discussion of the resolutions they propose in their memos to validate the time they spend doing them. And some discussion of memo format and construction also helps them spend more out-of-class time on the issue rather than the mechanics.

All of this means trading off time that could be used teaching more basic finance tools, methods and theories. But because there are numerous studies that indicate the retention of specific content is less than what we wish it were, it seems spending time considering ethical dilemmas is valuable, especially if it leads to better-reasoned and more ethical decisions by our graduates. 

## Notes

<sup>1</sup> Peter Lattman and Annelena Lobb, "The Madoff Fraud Case: Victims' Speeches in Court Influenced Judge's Ruling," *Wall Street Journal*, June 30 2009, *ProQuest*.

<sup>2</sup> Joel M. Podolny, "The Buck Stops (and Starts) at Business School," *Harvard Business Review* 87, no.6 (2009): 62-67, *Business Source Complete*.

<sup>3</sup> Julie A.B. Cagle, Philip W. Glasgo, and Vanessa M. Holmes, "Using Ethics Vignettes in Introductory Finance Classes: Impact on Ethical Perceptions of Undergraduate Business Students," *Journal of Education for Business* 84, no.2 (2008): 77.

<sup>4</sup> Podolny, "The Buck Stops," 63.

<sup>5</sup> Carolyn Y. Nicholson, and Michelle DeMoss, "Teaching Ethics and Social Responsibility: An Evaluation of Undergraduate Business Education at the Discipline Level," *Journal of Education for Business* 84, no.4 (2009): 213.

<sup>6</sup> Cagle, Glasgo, and Holmes. "Using Ethics Vignettes," 77.

<sup>7</sup> Ibid.

<sup>8</sup> Douglas R. May, Matt Luth, and Catherine E. Schwoerer, "The Effects of Business Ethics Education on Moral Efficacy, Moral Meaningfulness, and Moral Courage: A Quasi-Experimental Study," *Academy of Management Annual Proceedings*, (2009): 1-6.

<sup>9</sup> Santa Clara University Markkula Center for Applied Ethics, "A Framework for Thinking Ethically," 2012, <http://www.scu.edu/ethics/practicing/decision/framework.html>.

<sup>10</sup> Arizona Character Education Foundation, "Making Ethical Decisions," 2013, <http://www.azcharactereducation.org/making-ethical-decisions/>.

<sup>11</sup> Santa Clara University Markkula Center for Applied Ethics.

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